

## **Arizona Foreign Trade Zone Property Tax Treatment**

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Arizona does not have an ad valorem inventory tax due to an express exemption in the Arizona Constitution. There is, therefore, no Federal tax preemption when the Foreign-Trade Zones Board approves a foreign-trade zone project in the state. Rather, Arizona and its elected officials, through the state Legislature, specifically structured a narrowly focused property tax rate reduction under Arizona law for activated foreign-trade zone projects. This was enacted by Arizona in 1991 for the purpose of stimulating international trade in the state.

The approval by the Board of a subzone application does not, by itself, convey a property tax benefit in Arizona. Board approval is only one of the final steps in a lengthy public process leading up to the classification of property within a foreign-trade zone for ad valorem tax purposes. Prior to the filing of any subzone application, the Grantee (in the case of Zone No. 75, through the Phoenix City Council) considers the impact of the proposed project, both from a land use and property tax impact perspective and, at a duly noticed public meeting, adopts a resolution or ordinance required to be submitted as part of the subzone application. After FTZ Board approval, the United States Customs Service must activate the subzone after inspecting the facility and reviewing the proposed operations.

Title 42, Chapter 12, Article 1 of the Arizona Revised Statutes provides the classifications of property for the purpose of taxation in Arizona. Although the rate of property taxation is uniform, taxes vary among these classes based upon the applicable percentage of the assessed property valuation that is used to calculate the tax, ranging from 1% to 28% of the assessed valuation for the nine classes of property. Normally, a manufacturing or distribution facility would fall within Class 1 and would be taxed at the commercial property rate of 25% of assessed valuation, as provided in A.R.S. 42-12001. However, real property and personal property located within the boundaries of an activated foreign-trade zone or subzone are covered by Class 6(1). In accordance with A.R.S. 42-12006, all Class 6 property is taxed at the rate of 5% of assessed valuation.

The same Class 6 property classification also applies to non-commercial historic property, property in a military reuse zone, property held by a qualified small or minority-owned manufacturing business in a state-designated “enterprise zone”, property being used solely for Arizona Department of Environmental Quality-approved environmental remediation and property comprising a state-certified qualified environmental technology, manufacturing, producing or processing facility. These designations provide property tax reductions for targeted activities that the Arizona

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Legislature encourages as a matter of Arizona state tax policy and were made after appropriate study and debate by the duly elected officials of the Arizona Legislature. The issuance of a Foreign-Trade Zones Board Order will not automatically preempt any Arizona tax law.

Importantly, Class 6(1) applies only to real and personal property located within an activated foreign-trade zone or subzone, thereby ensuring that the subzone serves a bona fide customs purpose. The activation requirement was included by the Arizona Legislature to prevent the situation of a zone being established but never activated, resulting in the real and personal property being used for non-foreign-trade zone approved purposes while having the tax advantage.

Additionally, as Grantee of Foreign-Trade Zone No. 75, Phoenix will not recommend that its City Council authorize sponsorship of a subzone application without the approval of the local city jurisdiction where the proposed subzone is located, if not within Phoenix city limits. This ensures that all parties are aware of, and agree with, the tax impact of foreign-trade subzone designation. Furthermore, for subzones within its boundaries, the City of Phoenix requires the firm seeking subzone status to agree that it will claim the beneficial property tax treatment only for new buildings and equipment, not for existing real or personal property, thereby preserving current levels of property tax income. If the company still seeks to have all eligible property classified as Class 8, the agreement requires a payment in lieu of taxes in the amount of the savings, to be collected and disbursed by the City in the manner provided by statute for the distribution of property taxes, so that there is no reduction in actual dollars available to the intended beneficiaries of that revenue.

In January, 1997, the Arizona Center for Law in the Public Interest filed a lawsuit against the State of Arizona for declaratory and injunctive relief on behalf of a taxpayer in Chandler, Arizona (where Intel Corporation, Subzone 75C, is located), challenging the favorable property tax treatment for activated foreign-trade zones and subzones as a violation of the Uniformity Clause (Article IX, Section 1) of the Arizona Constitution. The lower court decision in favor of the State of Arizona (and Intervenor, Intel) was affirmed, in January, 1999, by the Arizona Court of Appeals, which found that the commercial/industrial properties within activated zones are rationally distinguishable from other commercial/industrial properties based upon legitimate differences in their physical or legal characteristics or their use, utility, purpose or productivity.